

Assembly Bill No. 1761

CHAPTER 95

An act to add Section 1033.5 to the Insurance Code, relating to insolvency.

[Approved by Governor July 21, 2005. Filed with
Secretary of State July 21, 2005.]

LEGISLATIVE COUNSEL'S DIGEST

AB 1761, Committee on Insurance. Insolvency: deductible agreements.

Existing law generally regulates the liquidation of insolvent insurers. Existing law establishes the California Insurance Guarantee Association for purposes related to the payment of covered claims of certain insolvent insurers.

This bill would provide that any collateral held by or for the benefit of, or assigned to, an insurer or liquidator pursuant to these provisions to secure the obligations of a policyholder under a deductible agreement, as defined, and any reimbursement payments to the liquidator under a deductible agreement, shall be considered property of the liquidated company, but shall not be general assets of the liquidated company. The bill would impose certain requirements on the liquidator and the policyholder with respect to the payment of claims from this collateral, and would specify the obligations of the California Insurance Guarantee Association, or another guaranty association, regarding claims covered by this collateral. The bill would require that it be construed such that the claim payment obligations of the guaranty associations arising from deductible agreements will be substantially equivalent to those of the insurer, except as specified, had the insurer continued in business and not become subject to a liquidation proceeding.

The people of the State of California do enact as follows:

SECTION 1. Section 1033.5 is added to the Insurance Code, to read:

1033.5. (a) The purpose of this section is to clarify the rights and obligations of policyholders, claimants, guaranty funds, including the California Insurance Guarantee Association, and the liquidator with respect to a deductible agreement entered into between a policyholder and an insurer subject to liquidation proceedings under this article. These arrangements are commonly referred to as "large deductible" policies or programs, even though the actual amount of the deductible can vary significantly and may not be in fact large in amount. Deductible amounts under these arrangements may vary from as little as five thousand dollars (\$5,000) to as much as \$1,000,000 or more. This section shall be construed

such that the claim payment obligations of the guaranty associations, including the California Insurance Guarantee Association, in total arising from deductible agreements will be substantially equivalent to those of the insurer, except as provided otherwise in each guaranty association's enabling statute, including that of the California Insurance Guarantee Association, had the insurer continued in business and not become subject to a liquidation proceeding.

(b) Notwithstanding any other provision of law or contract to the contrary, any collateral held by or for the benefit of, or assigned to, the insurer or the liquidator to secure the obligations of a policyholder under a deductible agreement and any reimbursement payments to the liquidator under a deductible agreement shall be considered property of the liquidated company, but shall not be general assets of the liquidated company. The liquidator shall maintain, administer, and distribute all such collateral and deductible reimbursement payments only as provided in this section.

(c) If a claim that is subject to a deductible agreement and secured by collateral is not covered by a guaranty association or the California Insurance Guarantee Association and the policyholder is unwilling or unable to take over the handling and payment of the noncovered claims, the liquidator shall adjust and pay the noncovered claims utilizing the collateral, but only to the extent the available collateral, after allocation under subdivision (d), is sufficient to pay all outstanding and anticipated claims. If the collateral is exhausted and the policyholder is not able to provide funds to pay the remaining claims within the deductible after all reasonable means of collection against the policyholder have been exhausted, the remaining claims shall be claims against the insurer's estate, subject to the other provisions of this article regarding the filing and allowance of claims. When the liquidator determines that the collateral is insufficient to pay all additional and anticipated claims, the liquidator may file a plan for equitably allocating the collateral among claimants, subject to court approval.

(d) (1) To the extent that the liquidator holds collateral provided by a policyholder that was obtained to secure a deductible agreement and to secure other obligations of the policyholder to pay the insurer, directly or indirectly, amounts that become assets of the estate, such as reinsurance obligations under a captive reinsurance program or adjustable premium obligations under a retrospectively rated insurance policy or where the premium due is subject to adjustment based upon actual loss experience, the liquidator shall equitably allocate the collateral among those obligations and administer the collateral allocated to the deductible agreement pursuant to this section.

(2) With respect to the collateral allocated to obligations under the deductible agreement, if the collateral secured reimbursement obligations under more than one line of insurance, then the collateral shall be equitably allocated among the various lines based upon the estimated ultimate exposure within the deductible amount for each line.

(3) The liquidator shall inform the guaranty associations or the California Insurance Guarantee Association that is or may be obligated for claims against the insurer of the method and details of each allocation made pursuant to this subdivision.

(4) The liquidator shall be entitled to deduct from the collateral or from the deductible reimbursements reasonable and actual expenses incurred in connection with the collection of the collateral and deductible reimbursements under this section.

(e) (1) Regardless of whether there is collateral, if the insolvent insurer has contractually agreed to allow the policyholder to fund its own claims within the deductible amount pursuant to a deductible agreement, either through the policyholder's own administration of its claims or through its provision of funds directly to a third-party administrator who administers the claims, the liquidator shall allow the funding arrangement to continue and, where applicable, shall enforce the arrangement to the fullest extent possible. The funding of any of these claims by the policyholder within the deductible amount, including, but not limited to, any of these claims by the policyholder or the third-party claimant, shall bar a claim for that amount in the liquidation proceeding.

(2) The funding of claims pursuant to paragraph (1) shall extinguish the obligation, if any, of a guaranty association or the California Insurance Guarantee Association to pay the claims within the deductible amount, as well as the obligation, if any, of the policyholder or third-party administrator to reimburse the guaranty association or the California Insurance Guarantee Association. No charge of any kind shall be made by the liquidator against any guaranty association or the California Insurance Guarantee Association on the basis of the policyholder funding of claims payment made pursuant to the mechanism set forth in this subdivision. The funding of these claims by the policyholders shall not limit or prejudice any right the guaranty association or the California Insurance Guarantee Association may have with respect to these claims under state law. Any policyholder that funds its own claims under the provisions of this subdivision shall provide to the guaranty association or to the California Insurance Guarantee Association all relevant information concerning the claim whenever the policyholder's reserved liability for the claim equals or exceeds 50 percent of the deductible amount on the claim.

(f) (1) If the insurer has not contractually agreed to allow the policyholder to fund its own claims within the deductible amount, to the extent a guaranty association or the California Insurance Guarantee Association is required by applicable state law to pay any claims for which the insurer would be or would have been entitled to reimbursement from the policyholder under the terms of the deductible agreement, and to the extent the claims have not been paid by a policyholder or third party, the liquidator shall promptly bill the policyholder for the reimbursement. The policyholder shall pay that amount to the liquidator for the benefit of the California Insurance Guarantee Association or the guaranty association that paid the claims. Neither the insolvency of the insurer, nor its inability

to perform any of its obligations under the deductible agreement, shall be a defense to the policyholder's reimbursement obligation under the deductible agreement.

(2) When the policyholder reimbursements pursuant to paragraph (1) are collected, the liquidator shall promptly reimburse the guaranty association or the California Insurance Guarantee Association for claims paid that were subject to the deductible. If the policyholder fails to pay the amounts due within 60 days after the bill for the reimbursements is due, the liquidator shall use the collateral to the extent necessary to reimburse the guaranty association or the California Insurance Guarantee Association, and, at the same time, may pursue other collections efforts against the policyholder. If more than one guaranty association or the California Insurance Guarantee Association has a claim against the same collateral, and the available collateral, after allocation under subdivision (d), along with billing and collection efforts, are together insufficient to pay each guaranty association or the California Insurance Guarantee Association in full, then the liquidator shall prorate payments to each guaranty association or the California Insurance Guarantee Association based upon the relationship the amount of claims each guaranty association or the California Insurance Guarantee Association has paid bears to the total of all claims paid by the guaranty association or the California Insurance Guarantee Association.

(g) (1) With respect to claim payments made by any guaranty association or the California Insurance Guarantee Association, the liquidator shall promptly provide the court, with a copy to the guaranty association or the California Insurance Guarantee Association, with a complete report of the liquidator's deductible billing and collection activities, including copies of the policyholder billings when rendered, the reimbursements collected, the available amounts and use of collateral for each policyholder, and any proration of payments when it occurs. If the liquidator fails to make a good faith effort, within 120 days of receiving a claims payment report, to collect reimbursements due from a policyholder under a deductible agreement based on claim payments made by one or more guaranty associations or the California Insurance Guarantee Association, then the guaranty association or the California Insurance Guarantee Association may pursue collection from the policyholders directly on the same basis as the liquidator, and with the same rights and remedies, and shall report any amounts so collected from each policyholder to the liquidator. To the extent that the guaranty association or the California Insurance Guarantee Association pays claims within the deductible amount, but is not reimbursed by the liquidator under this section or by policyholder payments from the collection efforts of the guaranty association or the California Insurance Guarantee Association, the guaranty association or the California Insurance Guarantee Association shall have a claim against the insolvent insurer's estate for the unreimbursed claims payments.

(2) The liquidator shall periodically adjust the collateral being held as the claims subject to the deductible agreement are satisfied, provided that adequate collateral is maintained to secure the entire estimated ultimate obligation of the policyholder plus a reasonable safety factor, and provided further that the liquidator shall not be required to adjust the collateral more than once a year. The guaranty associations or the California Insurance Guarantee Association shall be informed of any collateral adjustment, including but not limited to, the basis for the adjustment. Once all claims covered by the collateral have been paid and the liquidator is satisfied that no new claims can be presented, the liquidator shall release any remaining collateral to the policyholder.

(h) The court having jurisdiction over the liquidation proceedings shall have jurisdiction to resolve disputes arising under this provision.

(i) Nothing in this section is intended to limit or adversely affect any right a guaranty association or the California Insurance Guarantee Association may have under applicable state law to obtain reimbursement from certain classes of policyholders for claims payments made by the guaranty association or the California Insurance Guarantee Association under policies of the insolvent insurer, or for related expenses the guaranty association or the California Insurance Guarantee Association incur.

(j) This section shall apply only with respect to insolvencies occurring on or after January 1, 2006.

(k) For purposes of this section, the following definitions apply:

(1) “Collateral” means any form of security held to secure the obligations of a policyholder under a deductible agreement with an insurer subject to an order of liquidation under this article.

(2) “Deductible agreement” means any policy, endorsement, contract, or security agreement, or a combination of any of those items, that provides for the policyholder to bear the risk of loss within a specified amount per claim or occurrence covered under a policy of insurance, and may be subject to the aggregate limit of policyholder reimbursement obligations.

(3) “Noncovered claim” means a claim that is subject to a deductible agreement and is not covered by a guaranty association or the California Insurance Guarantee Association.

(l) This section shall apply to claims funded by a guaranty association or the California Insurance Guarantee Association in excess of the deductible only if subdivision (e) is applicable.

SEC. 2. This act does not constitute a change in, but is declaratory of, existing law with respect to the entitlement of the California Insurance Guarantee Association to the policy deductibles of an insolvent insurer.

CORRECTIONS:
Text - Pages 2 and 3.

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